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SUBJECT: Shandong's Economy Hit by Economic Slowdown but Still
Plodding Along
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¶1. (SBU) Summary: Shandong Province, China's second largest in terms of GDP and population, has witnessed a significant drop in trade and foreign investment during the first two months of 2009, according to contacts in Jinan and Qingdao who recently met with EconOff. However, contacts asserted that the province has weathered the global economic slowdown better than China's other coastal provinces because Shandong is home to many favored state-owned firms. Declining trade has slowed growth in cargo volume at the Qingdao port but has not forced lay-offs or affected expansion plans. Many smaller Korean enterprises have been particularly hard hit and have left Shandong, although one contact downplayed the impact of their departure on the overall economy. End Summary.

¶2. (SBU) EconOff visited Shandong's provincial capital of Jinan and coastal city of Qingdao February 25-27 under the framework of the Embassy's Virtual Presence Post (VPP) program. EconOff met with Director of the Chinese Academy of Social Sciences (CASS) Shandong Economic Research Institute Zhang Weiguo, Director of the America and Oceania Division of the Shandong Foreign Trade and Economic Cooperation Department Fang Xiaojie, Vice Director of the Qingdao Port General Office Han Baolin, and Republic of Korea (ROK) Consulate official Lee Xiangzhen.

Sharp Decline in Trade and Investment

¶3. (SBU) Trade and investment in Shandong have both suffered from the global economic slowdown, according to Shandong Foreign Trade and Economic Cooperation Department Director Fang Xiaojie. In 2008, Shandong's total trade increased 29 percent, with exports rising 23 percent and imports increasing 37 percent. Shandong's trade volume started to decrease in November and December, a trend that continued in January 2009, when exports fell 10.1 percent, imports decreased 44.7 percent and total trade declined 25.3 percent. February was another difficult month, with a 25.3 percent decline in exports, 12.1 percent drop in imports and 19.8 percent decrease in total trade. Fang predicted further drops in trade in the coming months. As for investment, FDI in Shandong in 2008 increased 10.2 percent y-o-y to reach USD8.2 billion, with 65.7 percent invested in industries, 29.7 percent in the service sector and 4.7 percent in agriculture. In January 2009, FDI was down 21.4 percent y-o-y to USD438 million.

Shandong's Elephant Economy Weathers the Storm

¶4. (SBU) In spite of declining trade and investment, the impact of the global financial crisis on Shandong Province has been relatively limited, CASS's Zhang Weiguo told EconOff February 25. He

attributed Shandong's relatively strong position to several factors. First, Shandong's economy is not as export-oriented as the Southern coastal provinces of Guangdong, Zhejiang and Jiangsu. Second, Shandong is characterized as an "elephant" economy, with many large state-owned enterprises (SOEs) that enjoy strong government support and are in a better position to withstand the crisis than private firms. Industry makes up 58 percent of Shandong's GDP, while the service sector accounts for 33 percent and agriculture less than 10 percent.

Government Response: Rebates, Investment, New Trade
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¶5. (SBU) Zhang claimed the Shandong provincial government's 1.6 trillion yuan stimulus package is providing a boost to industries affected by the economic slowdown. The stimulus funds are being used for large-scale infrastructure projects including railway, port and airport construction as well as projects that promote rural development, industry restructuring, energy saving, emission reductions and environment protection. Before the central government announced its 4 trillion yuan stimulus package, Shandong Province already had plans to build a new port, four east-west railways and four north-south railways. According to Zhang, some of these large infrastructure projects will receive stimulus package funds from the central government.

¶6. (SBU) Fang Xiaojie said the provincial government has responded to declining trade and investment by adopting a number of measures that aim to increase liquidity, expand domestic demand and promote trade. Shandong has encouraged investment in alternative energy sources such as wind power, promoted the export of agricultural products and increased export rebates on certain products. Fang will lead a delegation of more than 30 Shandong agricultural

companies to Texas and Ohio later this month to seek trade partners. He also noted that Shandong was hoping to develop new markets in developing economies in Africa.

Qingdao Port: Slower Growth but Continued Expansion
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¶7. (SBU) The global financial crisis has slowed growth in Qingdao's port cargo volume but has not led to layoffs or affected expansion plans, Qingdao Port Vice Director Han Baolin told EconOff. The Qingdao container wharf was opened in 2004 with a total investment of USD887 million from three shipping companies - Chinese-owned COSCO, Danish-owned Maersk and British-owned P&O. Port volume has grown steadily since that time but only increased 12 percent in 2008, considerably less than the originally projected 18-20 percent increase. January 2009 saw a 5 percent y-o-y increase in port volume. (Note: A 5 percent increase over the previous January probably translates into a real contraction over the previous month. End note.) Han claimed that none of the 22,000 port employees had been laid off but acknowledged that some port companies had reduced workers' hours or adopted flexible working hours. He said the economic slowdown had not affected their expansion plans, noting the ongoing construction of a new wharf with 10 berths and plans to build a new port with capacity of 300 million tons in the next three to five years. The new port will handle iron ore, crude oil and bulk shipments.

Korean Firms Are Leaving

¶8. (SBU) Many South Korean firms have gone bankrupt and left Shandong Province in the last year, according to Lee Xiangzhen, an official at the Republic of Korea Consulate in Qingdao. Lee estimated that approximately 15 percent of Qingdao's sizable Korean population has left the province since the beginning of 2008. (Note: The South Korean Chamber of Commerce estimates that as many as 30 percent of the 100,000 Koreans have left, but Lee expressed doubt about this figure. An American businessman in Qingdao told EconOff that enrollment has dropped 14 percent at one of Qingdao's largest international schools, where 75 percent of the student body was Korean.) Those paid in Korean currency have been particularly hard hit by the significant devaluation of the Korean Won. Some firms have abruptly left Shandong without paying their workers' salaries, creating a "big headache" for the Korean Consulate, which

has faced angry complaints from local authorities. In some cases, the local government has provided compensation to the laid-off workers. CASS's Zhang said that most of the South Korean firms that left the province were small family firms whose departure did not significantly impact Shandong's overall economy.

Comment: An Elephant Wearing Rose-Colored Glasses?

¶9. (SBU) Shandong boasts some of China's largest state-owned enterprises, including the mammoth white-goods producer Haier. Many of these SOEs expect to benefit from the Chinese government plans to spur domestic demand and allow industrial consolidation. However, Shandong also faces some serious problems. While less dependent on exports than some of its neighbors, much of Shandong's wealth and development has come from processing trade centered on Japanese and Korean investors. This sector of the export market has been particularly hard hit by the global economic downturn and is not expected to recover quickly. Further, as a major agricultural and petroleum producer, the collapse of international commodity prices has hit Shandong hard. The government response is important, and in the near-term government infrastructure investment should start to replace local private production. In the medium- to long-term Shandong's SOEs will almost certainly benefit from a gradually increasing reliance on domestic demand to drive the Chinese economy. But Shandong, like the rest of China's coastal provinces, still faces several months of economic pain.
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